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Synopsis

Perspective—*Mexico's Handling of the Debt Problems* 25X1

President de la Madrid's impressive mastery of Mexican politics combined with tough economic policies have made Mexico the star performer among major LDC debtors. His political success, however, has kept many observers from noticing that important economic reforms are still needed to avoid future financial crises. 25X1

International Financial Situation: Debt Rescheduling Update 25X1

This article is part of a special series of articles on the economic and political aspects of the international financial situation. The article examines the unprecedented magnitude of debt relief provided this year—$55 billion rescheduled so far compared with the previous record of $8 billion in 1981. 25X1

Mexico: The Austerity Record and Economic Adjustment 25X1

During his first year in office, President de la Madrid has done an impressive job in convincing Mexicans that tough economic policies have been necessary. Because much still remains to be done to bring the massive foreign debt and rapid inflation under control, we foresee a continued deterioration of the economy. Moreover, broader structural reforms must be undertaken if Mexico is to avoid recurrent financial problems. 25X1

Italy: Dealing With Decline 25X1

We believe Rome will fall short of its economic policy targets this year and next. Nonetheless, policies already in train suggest a weak recovery after three years of recession 25X1

Syria: How Socialist Is It? 25X1

Despite President Hafiz al-Assad's strongly socialist rhetoric, Syria maintains a "dual economy" in which the failings of the state sector are partially compensated for by a thriving private sector that is allowed to evade official regulation. The economic and financial cushion provided by the private sector's illegal activities helps cushion Assad against foreign financial pressures. 25X1

Free World Competition for Commercial Space Services 25X1

Growing foreign competition in space services poses a number of challenges to the United States, both on the commercial and security fronts. 25X1

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Perspective

Mexico's Handling of the Debt Problem 25X1

President de la Madrid's impressive mastery of Mexican politics combined with tough economic policies have made Mexico the star performer among major LDC debtors. Domestic confidence in the ruling party-government complex is beginning to rebound, and opportunities for the opposition to unite against the austerity program have been undercut by presidential flexibility. At the same time, a firm hand in dealing with leftist parties, some Communist-dominated unions, and antiausterity demonstrators has kept a lid on protests. De la Madrid's political success, however, has kept many observers from noticing that important economic reforms must still be introduced if Mexico is to avoid recurrent financial crises. Although the President earlier endorsed basic structural adjustments, at this point it is not certain that he has the determination or the political leverage to make such severe changes. 25X1

The power of the presidency is paramount in Mexico, and de la Madrid's personal philosophy and style have had a major impact on the public mood. Regarded early on as a political neophyte, de la Madrid during his first year has demonstrated considerable political savvy. Recent public opinion polling indicates that his low-key, down-to-business style and vigorous attack on inefficient policies have convinced many Mexicans that continued belt tightening is appropriate and that burdens are being shared equally. A vigorous anticorruption campaign has targeted even key ruling party loyalists, in part to show that the government too must sacrifice. His administration's National Development Plan calls for extended economic retrenchment, while stressing equity and promising that living standards of the poor will be protected, in part by eliminating privileges of the rich. In an effort to lower tensions in urban slums—considered by the ruling party as potential flashpoints—de la Madrid has kept up food supplies through large commodity imports from the United States and maintained subsidies on basic items. 25X1

Retaining support of organized labor has been key to keeping austerity going and, in our opinion, de la Madrid's most notable achievement. He has provided progovernment unionists with enough "victories" to keep their followers in line, while avoiding the impression among hard-hit businessmen that he is totally in the union camp. Labor chief Fidel Velazquez, while stressing that union support is not unconditional, has put his substantial political weight behind moderation to help preempt problems with labor. These maneuvers increased confidence in de la Madrid's ability to handle challenges to the system without resorting to repression. 25X1

The President's iron will and skillful negotiating tactics to date have earned him the grudging cooperation of business and the middle class. A labor-government-business solidarity pact announced in August committed the signatories to distribute the burdens of austerity evenly and reduce the effects on the poor by providing basic consumer goods. Although attacked by nonestablishment labor and criticized by some rank-and-file unionists, the solidarity pact has held together. Despite plunging real wages, we see little likelihood of pressures from big labor for additional wage increases this year. [redacted] 25X1

Nevertheless, businessmen are concerned about the absence of an explicit role for private enterprise in de la Madrid's policy statements. Even though he has not specifically called for more nationalizations, many private-sector entrepreneurs believe government ownership of productive capacity will increase. Their fears have been fed by the recent decree that sharply increased the government's role in the automobile industry and by early drafts of restrictive regulations for the pharmaceutical and computer industries. [redacted] 25X1

The President's political skill has diminished tensions and the chances of widespread opposition to austerity that some observers had predicted. Nonetheless, potential for unrest remains high, in part because sticking to the IMF program will require additional cuts in public spending and perhaps a net reduction in the public-sector work force. High inflation will continue squeezing labor and the middle class. With crime and unemployment rising, spontaneous riots in urban squatter areas are possible at any time. [redacted] 25X1

Instituting structural economic reforms will be even more difficult than maintaining austerity because major interest groups will see the basis of their privileged status undermined. So far, de la Madrid has just laid the groundwork by cutting real wages, reducing public outlays, and devaluing the peso. To keep these gains from being eaten away, additional, politically risky measures must follow. In the external sector, not only must the exchange rate be kept realistically valued, but trade and investment barriers that protect inefficient domestic industries from international competition need to be sharply limited. Domestic prices will have to be brought more closely in line with international levels, and wages will have to be contained to permit investment to be financed from domestic resources. [redacted] 25X1

Even with a year of political successes behind him, de la Madrid's willingness to move forward on basic reforms is in doubt. Policy drift in two areas raises the specter of backsliding. First, the administration's decision to maintain the dual exchange rate and depreciate by only 13 centavos a day is causing the peso's competitive edge to be rapidly eroded; Mexican inflation dramatically outpaces the rate of its major trading partner, the United States. Secondly, de la Madrid has failed to gain control of bloated public-sector enterprises. During the last 12 months, while employment in the rest of the economy has

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contracted sharply, the public-sector work force grew slightly. Mexico City still has not yet decided what to do with the 300 or so nonfinancial businesses that were acquired when Mexico City nationalized the banks in September 1982. Unless the government makes basic policy reforms, sacrifices similar to those demanded of the Mexican people in the last 18 months will be required repeatedly as financial crises persist. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

Nigeria-OPEC Discord Over Production Levels

Nigerian officials are angry about increased oil production in Saudi Arabia and Iran and are relaxing controls on output imposed in August. This decision to increase output could lead to more violations of the shaky OPEC accord and put the cartel in a poor position to defend prices when seasonal demand weakens early next year. Nigeria previously had ordered foreign operators to limit production to the country's OPEC allocation of 1.3 million b/d through the end of the year. According to the US Embassy, the officials say that, because other OPEC members are exceeding their quotas, Nigeria will produce an additional 100,000 b/d until overall OPEC production falls within its ceiling. OPEC production currently is running nearly 1.5 million b/d above the cartel's self-imposed limit of 17.5 million b/d.

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OECD Nuclear Power Grows

Nuclear power generation in the OECD countries was 14 percent higher in third-quarter 1983 than in the same period a year earlier—reaching 4.1 million b/d oil equivalent. Nuclear power generation in France soared by

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OECD: Gross Nuclear Electricity Generation

	3rd Quarter 1982	3rd Quarter 1983	Percent Change
	Terawatt-hours		
OECD	**188.5**	**214.9**	**14.0**
United States	79.9	81.4	1.9
Japan	27.5	29.6	7.6
Canada	10.7	13.1	22.4
Western Europe	70.4	90.8	29.0
Belgium	3.1	7.2	132.3
Finland	4.2	4.3	2.4
France	22.5	35.5	57.8
Italy	1.6	1.8	12.5
Netherlands	1.1	1.1	0
Spain	2.1	2.5	19.0
Sweden	7.0	7.3	4.3
Switzerland	3.1	3.6	16.1
United Kingdom	11.2	11.8	5.4
West Germany	14.5	15.7	8.3

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nearly 60 percent and now represents the equivalent of 670,000 b/d of oil. In the past 12 months, five nuclear power plants in France have come on line and two more have begun low-power startup and testing. The increase in nuclear power production in Belgium results from the 1982 shutdown for maintenance and refueling. Nuclear power generation rose in other OECD countries despite little growth in electricity demand. We expect OECD electricity demand to resume about 3-percent growth next year as the economic recovery gains momentum. Nuclear power generation is expected to rise more rapidly and increase its share of electricity generation. [redacted] 25X1

Big Seven Electricity Consumption Begins To Recover [redacted]

Electricity demand during the second quarter of 1983 in the Big Seven increased by 1 percent—about 200,000 b/d oil equivalent—compared with the same period a year ago. Six of the Big Seven countries showed increases in demand with the United Kingdom growing by 4.4 percent, France by 2.8 percent, and Canada by 2.7 percent. 25X1 The sharp rise in electricity demand in the United Kingdom resulted from a rapid increase in chemical and primary metal production. US electricity use was up only 0.6 percent in the second quarter; improved economic factors combined with the July and August heat wave probably boosted electricity demand in the third quarter. Electricity demand is expected to reach previous growth rates of about 3 percent a year as the economic recovery gains momentum around the world. Increased demand will boost oil and gas consumption by electric utilities, at least in the short term, pending the completion of new nuclear and coal-fired generating capacity. [redacted] 25X1

[redacted]

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Japanese Cut Forecast of Coal-Fired Power Plants [redacted]

After reducing electricity demand forecasts for the 1990s by 17 percent earlier this year, Japan is now slashing projections for coal-fired electric generating capacity for 1990. Because of the favorable economics of nuclear power and the stiff penalties that would be incurred as a result of the "take or pay" clauses in LNG contracts, coal-fired generating capacity will bear the brunt of the decline in electric power requirements. [redacted] coal-fired capacity in 1990 is now expected to reach only 14,000

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megawatts-electric (MWe), compared with the previous forecast of 23,000 MWe. Coal consumption by the electric power sector has been revised downward to about 26 million metric tons, down nearly 16 million tons from last year's forecast. The United States, being the high cost coal supplier to Japan, probably will feel this cutback most severely. [redacted] 25X1

Greek Coal Tender

[redacted]

According to the Greek Energy Minister, the government will soon submit a single international tender for the country's 1984 steam coal needs of approximately 3 million metric tons—worth roughly $135 million. Greek Government officials doubt that US suppliers will obtain the sale. Aside from the high cost of US coal, the Greeks favor barter arrangements that the Canadian and Australian Governments have indicated a willingness to accept. Moreover, the Greeks desire a single bid and contend that the smaller US exporters stand a chance only if the US Government coordinates all offers and presents Greece with a single bid. US coal exporters have been hindered in the past when large foreign buyers prefer to deal with only a few sellers. [redacted] 25X1

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Nigerian Oil Discovery

[redacted]

Nigeria's National Petroleum Corporation (NNPC) has announced a new discovery of offshore oil in the Cross River delta near Port Harcourt. NNPC officials stated that the test well produced at two levels—24-degree API heavy crude from the upper reservoir and 39- to 40-degree API light crude from the lower reservoir. The officials are optimistic that the heavier crude eventually can replace Venezuelan oil that currently is imported and blended with Nigerian crude to create a suitable mix for Nigeria's refineries. Under a swap arrangement, Nigeria and Venezuela exchange about 25,000 b/d of oil, but Lagos must pay an undisclosed amount of hard currency for the more expensive Venezuelan crude. Nigeria most likely will develop the find rapidly—despite excess productive capacity—to replace the Venezuelan crude and conserve foreign exchange. [redacted] 25X1 25X1

Ecuador Has Trouble Selling Oil Exploration Rights

[redacted]

Despite an official statement by Quito that it was "very happy" with its recent sale of oil exploration rights, bad experiences with previous Ecuadorian administrations and an unattractive new hydrocarbons law limited bidding by most major foreign oil companies. According to Embassy reporting, at the end of last summer over 20 companies had purchased one or more geologic data packages—at $50,000 per packet—and the oil ministry was optimistic that competition over 11 blocks of land offered for bid would be high. When the sale was closed last month, however, only six offers were received, covering just four tracts. Only one block near the major producing fields in eastern Ecuador elicited more than one bid. Quito has not released further details on the offers but is expected to announce by the end of the year whether it will accept the bids. [redacted] 25X1 25X1

USSR Oil and Gas Exploration in the Barents Sea

[redacted]

The USSR recently signed an agreement with Norwegian Petroleum Consultants for a general work plan for exploration and development of oil and gas deposits in the Barents Sea. This undertaking by a consortium of small Norwegian firms is a preliminary step in systematically exploring and developing the area. The Norwegians will provide technical assistance and management services for an exploration area covering about one-third of the central Barents Sea, primarily near shore in waters of less than 60 meters depth. Thus far, the Soviets are reported to have mapped 15 to 20 structures in the area, including several large features which cover a 10-square-kilometer area. [redacted] 25X1 25X1

The Soviet motive for concluding an agreement with the Norwegians was political as well as economic. By jointly working with the Norwegians, the Soviets hope to create a more harmonious atmosphere between the two nations that will facilitate negotiations of the offshore boundary dispute in the area. Economically the Soviets need to locate large new oil discoveries to supply long-term energy needs. No large onshore oil discoveries have been reported since the West Siberian fields were found in the 1960s; offshore the search has only begun. The Soviets currently have little offshore technical capability and the project opens a "door"—albeit a small one—to the West's providing access to state-of-the-art equipment and technology. The Soviets remain concerned over US trade controls and the Norwegians can provide initial technical support and guidance. In the event of a major discovery, the Soviets realize that only major UK and US oil companies have the financial and technical resources to undertake development [redacted] 25X1

International Finance

Argentine Election Results Will Speed Debt Talks

[redacted]

Raul Alfonsin's decisive win in last Sunday's balloting for the presidency will enable him to begin discussions with international lenders almost immediately. Closer election results, which were widely expected, would have delayed the selection of a president for up to two months and held up debt negotiations. By scoring a clean victory, however, Alfonsin has the military's blessing to resume the stalled debt talks. Lenders will be pleased to begin negotiations that will be acceptable to the new civilian government [redacted] 25X1 25X1

Argentina needs to put rescheduling discussions back on track so it can obtain fresh flows of foreign exchange to avoid default and to maintain the import levels needed to run the economy. Alfonsin will enter the talks bound by a campaign promise to obtain better terms than those offered to the outgoing military regime, but initial press reporting indicates a willingness to work pragmatically toward agreement with foreign creditors. Bankers still appear ready to disburse $500 million in loans quickly—necessary to clear arrearages blocking access to an additional $1.6 billion in credit—if Buenos Aires can get negotiations restarted. [redacted] 25X1

Philippines Faces Import Shortages

[redacted]

The collapse of import financing is deepening Manila's economic crisis and could cause further political problems for President Marcos in the weeks ahead. The press reports that the banking system has stopped issuing new letters of credit because of the shortage of foreign exchange. Philippine officials are reportedly threatening to institute a foreign exchange rationing system for importers if the banks do not make more foreign exchange available in the next few days. Shortages of imported goods are not yet evident, but prices of many goods sold from inventory stocks are rising rapidly in anticipation of shortages. The government has responded by freezing prices for goods it considers to be affected by speculative buying or by the 21-percent devaluation last month. While there is an 80-day supply of oil, the Labor Minister is warning that the government may ration oil products to stretch supplies while prices are frozen. The Philippine National Oil Company, meanwhile, continues to fall further behind in its payments to major US banks, and its efforts to raise new money to finance oil imports have met with little success. [redacted] 25X1

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Foreign exchange will remain scarce at least through the end of the year. Central Bank reserves have fallen from slightly over $2 billion in mid-August to about $300 million. Interest payments on the foreign debt are running about $180 million per month, and the National Oil Company could not pay the $38 million it owed in principal repayment obligations at the end of October. Manila has little choice but to tighten control over foreign exchange if it wants to avoid serious economic disruption in the weeks ahead. [redacted] 25X1

Jamaica-IMF Discussions

[redacted]

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Jamaica and the IMF will undertake a new round of negotiations this week to try to break the impasse that developed when Kingston fell out of compliance with its Extended Fund Facility program in September. [redacted] 25X1 [redacted] the Fund is insisting that Jamaica abolish its dual exchange rate system and float the Jamaican dollar as a precondition to granting the island its second waiver in six months. 25X1 Kingston, however, will probably push for postponement until December since a float would probably result in a substantial devaluation. The Jamaicans will argue that thorough studies are needed to examine the impact of such a devaluation on government programs so that its effect can be minimized. Prime Minister Seaga—who prematurely announced the passage of Fund tests last month—needs to resolve the IMF breach quickly so Jamaica can restore import levels cut by the suspension of multilateral and some bilateral capital inflows and prevent external arrears. [redacted] 25X1

Somalia: Export Earnings Decline

[redacted]

Mogadishu's weak financial position has been hurt by Saudi Arabia's decision earlier this year to ban cattle imports from Somalia and other rinderpest-infected countries. Official statistics indicate that Somalia's livestock trade— 25X1 80 percent of export earnings last year—dropped 52 percent during May to September compared with a year earlier. US Embassy reporting indicates that Somalia could lose $65 million in foreign earnings this year, compounding foreign debt difficulties. The government already is in arrears to the United States and several other Western creditors, and Mogadishu is almost certain to seek debt relief and additional grant aid from its Western benefactors. 25X1

Global and Regional Developments

EC-US Specialty Steel Dispute Heating Up

Bonn will no longer block other Community members' attempts to retaliate against the United States for its specialty steel restrictions. A West German Economics Ministry spokesman told a US Embassy official last week that the EC, including the West Germans, are "fed up" with the United States over the specialty steel issue. West Germany found unacceptable the most recent US 25X1 offer to lower some trade barriers as compensation for its higher duties on specialty steel. The spokesman noted that Bonn was particularly aggravated by the continued filing of antidumping suits by US steel producers against West German firms. The EC appears increasingly likely to retaliate if an acceptable compensation arrangement cannot soon be worked out; the EC could decide its position at a Council meeting on 28 November. Bonn's decision to stop playing the mediator role within the EC will allow other members, particularly the French, to push through trade restrictions against US products. 25X1

EC Raises Flour Export Subsidy

The EC announced on 26 October a 10-percent increase in its subsidy for wheat flour sales to Egypt in an attempt to counter previous subsidized US flour sales to the country. The new subsidy applies to 400,000 metric tons of flour exports, and should result in a sale price of just over $200 a ton—slightly below current world prices. Egypt imports 1.5 million tons of flour a year—a 25X1 third of which it receives as food aid—and accounts for 20 percent of the world flour market. EC sales to Egypt fell 40 percent in 1982-83, and the Community hopes that revived trade will help reduce its burgeoning wheat stockpiles of 10.3 million tons. The increase was largely a response to pressure from France, the EC's largest wheat exporter and a fervent critic of American competition in the Egyptian flour market. Although the EC Commission maintains that the action should not be considered provocative, US Embassy sources report that the United Kingdom counseled against the action, warning that the United States would interpret it as a further trade challenge. 25X1

EC Farm Payments Frozen

The EC has suspended advance payments on agricultural supports, an unprecedented move that has caused an uproar among Community farmers. Under EC regulations agricultural exporters could claim up to 80 percent of their export subsidies in advance, and farmers were eligible for prepayment of 25X1 production aids for such commodities as soybeans, cotton, butter, and sugar. EC Agricultural Commissioner Poul Dalsager announced on 10 October that these advance payments would be suspended for 10 days, pending European Parliament approval of a special supplementary budget increase. Despite subsequent passage of the supplementary budget, the Commission on

19 October extended the suspension order to the end of the year to help prevent a projected $550 million budget shortfall for 1983. The suspension order is not part of efforts to reform the Common Agricultural Policy but is simply a temporary measure to conserve funds until 1984; EC Ministers will try to resolve their financial problems at the December Athens summit. The suspension will not have much effect on the EC's agricultural competition with the United States in third countries because only the timing of the payments will differ, not the ultimate amounts. 25X1

National Developments

Developed Countries

West German Growth Slightly Better Than Anticipated

On the basis of the strong upturn in domestic economic activity in first-half 1983, West Germany's five leading economic research institutes have issued a slightly more optimistic forecast for the economy by upping their projection of this year's real GNP growth to 1 percent. The institutes doubt, however, that the jump in private investment that supported the upswing earlier this year or Bonn's current economic policy will lead to a long recovery. They believe the recovery will lose strength in the second half of next year, leaving real growth in 1984 at 2 percent. Despite an anticipated poor export performance, the institutes set the 1983 current account surplus at about $4 billion—we believe it will be slightly higher. For 1984, the institutes expect export business to pick up and boost the current account surplus. The institutes doubt that the upswing will be vigorous enough to ease unemployment. The number of jobless

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West Germany:
Real GNP Growth Forecasts of Five Institutes [a]

Percent

	1983 Forecasts		1984
	Original	Revised	
GNP	0.5	1.0	2.0
Private consumption	0	1.0	1.0
Government consumption	0	−0.5	0
Investment	2.0	3.5	4.5
Equipment	1.0	5.5	4.0
Construction	3.0	2.0	4.5
Exports of goods and services	0	−1.0	3.5
Imports of goods and services	0.5	0	3.0
Consumer price index	3.0	3.0	3.0

[a] The five participating economic research institutes are Kiel Institute of the World Economy; HWWA Institute, Hamburg; IFO Institute, Munich; West German Institute for Economics (DIW), Berlin; and Rhine Westphalian Institute, Essen.

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is expected to average 2.3 million this year and could reach 2.4 million in 1984 even with a revival in the labor-intensive automotive and construction industries. 25X1

West German Exports Lagging

Sluggish exports are hampering economic recovery in West Germany. Real exports were almost flat during first-half 1983. We expect exports to rebound only a bit in the second half, given a recent pickup in foreign orders. Sales to the United States and industrialized countries outside the EC have been 25X1 improving slightly since April. Sales to EC countries—which account for about 50 percent of West Germany's exports—continue to be restrained by slow economic growth. Exports to OPEC countries—about 9 percent of West German exports—have fallen and are not likely to recover quickly, given slumping oil revenues. One of the few bright spots was sales to the Soviet Union, which ran 28 percent ahead of first-half 1982 in value terms. FRG import volume, on the other hand, grew at an annual rate of 9.4 percent in first-half 1983 in response to increased domestic demand. Higher imports, lagging export earnings, and a smaller services deficit will prevent the large increase in the current account surplus previously expected. We see the current account surplus growing only $1.5 billion above 1982 to $5 billion. 25X1

EC Capacity Utilization Rises

The rise in industrial capacity utilization in the European Community reported for the third quarter points to continued recovery. Seasonally adjusted capacity utilization averaged 77.2 percent during July-September, up from 76.4 percent in the first and second quarters—the lowest level since the bottom of the 1975 recession. 25X1 The West German and British rates posted the strongest advances in the third quarter, rising 1.9 percentage points and 1.4 points, respectively. Utilization rates fell in Italy and Ireland because of tighter monetary and fiscal policies, and in Luxembourg because of the soft world steel market. We expect capacity utilization to continue rising in the European Community, but business investment is not likely to pick up much in the near future. West European manufacturers will wait for clearer signs of an upswing before acting on investment plans. 25X1

Israeli Foreign Currency Controls

Finance Minister Cohen-Orgad banned foreign currency purchases by Israelis on Monday night to reduce the strong demand for foreign currency and to stem the downward pressure on the stock exchange. Exceptions will be allowed for importers and Israeli travelers going abroad, who can purchase up to 25X1 $3,000 of foreign currency. This action will do little to calm public uncertainty over Israel's economic future. On Tuesday, the black-market rate for dollars shot up to a 9-percent premium over the official rate as Israelis continued to buy foreign currency illegally. 25X1

British Plans To "Privatize" Communications Monopoly

The British Government has announced plans to sell 51 percent of state-owned British Telecom (BT) next fall—one of the largest transfers from public to private ownership ever undertaken. The size of the firm will make this complex sale difficult, but London does not want to break up BT because it believes less profitable divisions would be hard to sell. BT employs over 244,000 people and had sales of $10 billion last year. The transaction is expected to provide the government with at least $6 billion which could offset half of the $12 billion budget deficit anticipated for 1984/85. Last year total equity sales on the London Stock Exchange amounted to only $2.7 billion. Britain's Treasury Department is considering offering stock in foreign markets as well; the largest single offering in the United States has been only $1 billion. BT's management believes it must solve the problem of overmanning before the company can be sold. It has laid off 7,500 workers so far this year and plans additional cuts of 7,500. In response, the telephone unions have threatened to expand strike and lobbying activities to stop the sale unless jobs are preserved.

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West Germany Begins Partial Denationalization

Bonn has decided to reduce its 44-percent stake in Veba AG, the nation's largest company. The government will hold on to 25 percent of the energy conglomerate in order to maintain a blocking minority and ensure a government say in the energy sector. This is Bonn's first denationalization move since 1965, when it also reduced its holding in Veba, and others may follow. Bonn has direct stakes in some 56 domestic and foreign companies worth about $4 billion, and the conservative Kohl government sees this a part of its strategy to reduce the government role in the economy. According to press reports, Lufthansa could be denationalized next, and the sale of some Volkswagen stock may be in the offing. According to Finance Minister Gerhard Stoltenberg, the $270 million expected from the January 1984 sale of Veba will be used to reduce the federal budget deficit.

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Australia Fights Speculative Capital Flows

The Hawke government eased foreign exchange regulations last week to discourage short-term, speculative capital flows. Canberra put an end to the Australian Reserve Bank's daily fixing of the US dollar/Australian dollar exchange rate and to the daily fixing of the forward rate for the Australian dollar. The moves are designed to make it more difficult for speculators to profit from exchange rate movements. Large short-term capital inflows and outflows since the Hawke government assumed office last March—at times approaching $500 million a week—have hindered efforts to control money supply growth. It is currently running at an annual rate of 13 percent compared with a target of 9 to 11 percent. The new measures should not affect long-term capital inflows that Australia needs to finance its current account deficit of about $6 billion this year.

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South Africa's Midyear Budget Outlook

The South African Government has met its spending and revenue targets for the first half (April-September) of the current fiscal year, but Pretoria is likely to turn to international commercial borrowing to cover a deficit that probably

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will exceed the IMF guideline of 2 percent for the full year. Spending is currently running ahead of budget in some important categories—such as drought relief—and a 12-percent rise in civil service salaries is set for 1 January. The revenue outlook, moreover, is bleak. South Africa's continuing recession—real output is projected to decline by as much as 3 percent in 1983—is reducing taxable corporate and personal income, and a five-percent surcharge on imports must be dropped by the end of 1983 to meet another IMF condition. In addition, low gold prices are also holding down tax revenues. Government officials have told the US Embassy that they now project the budget deficit to reach 3.4 percent of GDP. New taxes would be an obstacle to economic recovery and are unlikely to be introduced before the next budget in March. South Africa is already negotiating a $100 million loan in West Germany, and its solid international credit rating probably will enable it to obtain additional foreign loans. [redacted] 25X1

Less Developed Countries

Lebanese Financial Difficulties

[redacted]

The Lebanese economy, which had been resilient since the 1975-76 civil war, has declined rapidly in recent months because of the deteriorating security conditions. Morale among businessmen is extremely low, and little investment is taking place. Unforeseen expenditures to resupply the Lebanese Armed Forces, coupled with reduced tax receipts because of lower economic activity, will result in a budget deficit more than double earlier projections, according to a banking source of the US Embassy. 25X1 Lebanese bankers, who already hold more than two-thirds of the government's debt, reportedly are reluctant to invest additional funds in President Gemayel's government. The trade deficit has increased considerably, in part because of larger military imports. Worker remittances, the most important source of foreign exchange, have dropped in recent months to less than one-third of their normal level because of the lack of confidence in the Lebanese economy. As a result, foreign exchange reserves that had remained high since the civil war have dropped $1.4 billion this year to $1.2 billion. [redacted] 25X1

The economy will continue to deteriorate unless early progress is made in the national reconciliation talks that started this week in Geneva. Even if an agreement on power sharing is worked out, we believe Lebanese and foreign investors will wait until after the agreement is demonstrated to be working before participating in reconstruction. The Central Bank Governor estimates that Lebanon will need $2 billion to tide the country over until the reconciliation process has made sufficient progress to boost investor confidence. He has asked the United States to consider a long-term, low-interest loan. [redacted] 25X1

Panama's Mounting Economic Problems

[redacted]

The Panamanian economy is headed into a deeper recession than earlier had been predicted. According to the US Embassy, Panamanian officials estimate real GDP will decline 2.8 percent in 1983, and recovery is unlikely to start before late 1984. Nationwide unemployment is running at 17 percent, [redacted] 25X1 a government official has stated publicly 25X1

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that unemployment in the Colon Free Zone area is near 60 percent. President de la Espriella announced in late October that employment commissions would be formed in several urban centers, including Panama City and Colon; their immediate goal will be to create new jobs. 25X1

Increase in Namibian Sales Tax

The South African–appointed administration in Namibia has raised the general sales tax rate from 6 to 7 percent on 1 November. Namibian officials describe the increase as part of an attempt by South Africa—on which
Namibia depends heavily for financial support—to make the territorial regime 25X1
more self-supporting and to avoid increases in Namibia's external debt. Pretoria has provided about $400 million in budget assistance to Namibia in each of the past two years and $200 million a year in loan guarantees. Announcement of the sales tax increase prompted sharp criticism from citizens' groups who blame their higher taxes on the favorable tax treatment
provided South African and international mining companies operating in the 25X1
territory. Local observers expect the tax rate to rise to 8 percent, probably by the end of the fiscal year in March, possibly triggering stronger protests.

Financial Crisis Threatens Central African Republic Regime

President Kolingba is facing some hard economic choices. The IMF last month
suspended the country's $20 million standby program for failure to meet 25X1
government spending guidelines. The move not only cuts off the shaky Bangui regime from additional IMF disbursements but also threatens access to French
funds needed to pay government salaries. The IMF is insisting on additional 25X1
government wage cuts before resuming disbursements. Kolingba is resisting because he anticipates that serious domestic unrest will follow; a salary reduction last February prompted calls for a general strike that was averted only by a strong government crackdown including the arrest of several labor
leaders. 25X1

Thailand Reduces Export Tax on Rice

Bangkok last month cut its export tax on rice to spur lagging sales. The volume of rice exports in the first half of 1983 had fallen 14 percent below the level of the same period a year earlier because of the soft international rice market.
The tax cut will stimulate sales, especially in price-sensitive African countries, 25X1
but Thailand's rice earnings still are likely to fall below the $950 million recorded in 1982. Next year, however, looks better for the world's largest rice exporter. The government projects a bumper 1983/84 crop of nearly 18 million metric tons—5 percent more than this year. Moreover, Thailand will benefit
from higher prices next year that are expected by market analysts. 25X1

Communist

USSR Comments on Economic Reform

Soviet officials recently provided insights on why the leadership is moving cautiously in introducing economic reforms. General Secretary Andropov has publicly encouraged steady change but has met with opposition in the
Politburo and economic bureaucracy. He has called for changes as part of the 25X1

Five-Year Plan for 1986-90, but statements by other leaders and reporting from other Soviet political observers indicate that the Politburo is undecided on the form and extent of change. [redacted] 25X1

Fedor Burlatskiy, a Soviet political commentator with ties to Andropov, told US Embassy officials in Moscow that economic reform has slowed primarily because the Soviet leadership has not agreed on the replacement of personnel or on a model for reform. He also says the leadership is concerned that economic reforms would induce social change. He asserts that concern in the USSR about the upheaval in Poland retarded prospects for reforms. In a separate conversation, *Izvestiya* economic editor Borodin told US Embassy officials that improved economic results for the first three quarters of this year are inspiring "new confidence" that some targets of the Five-Year Plan for 1981-85 can be achieved. He attributes the improvement to the discipline campaign and doubts that major new reforms will be introduced soon, partly because of international tensions. [redacted] 25X1

Moscow Assails Disregard of Decree to Spur Innovation

[redacted]

The Central Committee last week publicly attacked a major research and development facility—the Ural Scientific Center—for disregarding the regime's August decree on "measures to stimulate scientific and technical progress in the national economy." In reporting the Committee's criticism *Pravda* indicated that the decree was being widely ignored. The decree, a 25X1 highly publicized attempt to increase productivity and innovation, was for the most part hortatory and vague but did include a few specifics. For example, on 1 January 1984 all industrial output will be classified "top quality" or "first quality." Articles judged below "first quality" will be withdrawn from production within two years and in the meantime their prices will be cut 30 percent. Prices of articles classified "top quality" will be raised 30 percent. In addition, plant managers will be required to submit and fulfill an annual plan for the introduction of new technology or suffer a reduction in their total bonus payments of up to 25 percent. An official of the State Committee on Science and Technology has recently indicated that additional steps to implement the decree will include making "new funds" available for advanced equipment and facilities. He was unclear, however, about whether these "new funds" will change the level and allocation of investment. Directives from Moscow are not likely to remove constraints that inhibit technological development. Marginal improvement could result, however, from additional investment resources and the threatened sanctions if managers take their responsibilities more seriously.
[redacted] 25X1

International Financial Situation: Debt Rescheduling Update 25X1

This article is part of a special series focusing on the economic and political aspects of the international financial situation. 25X1

The unprecedented breadth and magnitude of debt servicing difficulties are starkly illustrated by the large number of countries that have obtained debt relief during 1983—21 through 1 November. Another 12 LDCs currently are in the process of renegotiating their debt and could reach agreements with their creditors by yearend. The previous high for a single year was 13 in 1981. Moreover, the volume of debt rescheduled already totals $55 billion, far outdistancing the 1981 sum of about $8 billion. The rapid growth rate of rescheduled debt is alarming to bankers and governments alike; the 33 rescheduling countries hold more than half of total LDC and East European debt. 25X1

Terms on 1983 reschedulings were generally tough, but in recent agreements—such as Brazil's second refinancing package this year—they have eased somewhat. Spreads on bank reschedulings were about 1.8 to 2.3 percentage points above LIBOR with maturities of six to eight years including two- to four-year grace periods. Official reschedulings generally contained maturities of 8 to 10 years including three- to four-year grace periods, with interest spreads determined on a bilateral basis. 25X1

New Developments in 1983

Among the 1983 debt reschedulings, several important patterns are evident:

- In contrast to previous years, private banks, foreign governments, and multilateral institutions—particularly the IMF—have combined their efforts into large-scale refinancing packages for debtors such as Mexico, Brazil, and Yugoslavia. These packages involve new money as well as rescheduling of current obligations and are often tied to adoption by the debtor of an IMF austerity program.

- The magnitude of the debt for troubled borrowers such as Brazil, Mexico, and Poland has caused most new bank lending to these LDCs to be involuntary. The large Western banks have had to provide much of the new lending to the large Latin American debtors because of the unwillingness of smaller banks to participate in the refinancing packages.

- The simultaneous rescheduling of debt by several large debtors has been unprecedented. This has accounted for the sharp increase in the volume of rescheduled debt in 1983. While some observers were concerned about the ability of the international financial system to handle this situation, the task has been accomplished thus far without pushing the system to the breaking point. 25X1

Key Countries' Debt Reschedulings

The largest concentration of 1983 reschedulings has occurred in Latin America, where nearly all of the countries have been involved. Developments in the major countries included: 25X1

- Mexico rescheduled about $20 billion in public-sector debt in August and September, but only $3 billion of Mexico's $15 billion private-sector debt has been rescheduled thus far.

- Brazil rescheduled $4.7 billion under its four-part refinancing package in early 1983. The new financing plan set up in September includes a rescheduling of $5.3 billion in 1984 maturities owed to banks and $2 billion in debt owed to foreign governments through the Paris Club.

Debt Reschedulings, 1983

Bank Debts Rescheduled	
Argentina	Nigeria
Brazil	Panama
Chile	Peru
Costa Rica	Poland [a]
Cuba	Romania [a]
Dominican Republic	Uruguay
Ecuador	Yugoslavia
Malawi [a]	Zambia
Mexico	
Official Debts Rescheduled	
Central African Republic	Peru
Costa Rica	Romania [a]
Cuba	Sudan
Malawi	Togo
Morocco	Zambia
Other Countries Seeking Rescheduling Before Yearend	
Bolivia	Niger
Honduras	Philippines
Jamaica	Senegal [a]
Liberia [a]	Uganda [a]
Madagascar [a]	Venezuela
Nicaragua	Zaire

[a] Countries that obtained debt rescheduling in 1982.

- Chile obtained debt rescheduling on $3.4 billion from private banks in August as part of a total financial package of $6.4 billion.
- Peru rescheduled $380 million in debt owed to banks in June. The Paris Club rescheduled over $1 billion in debt owed to foreign governments in July.
- Argentina refinanced about $1.5 billion in debt obligations to banks in March, but rescheduling of some $7.5 billion in public-sector debt has been slowed because of domestic political and legal problems.

Outside of Latin America, nearly all of the rescheduling activity has been in Eastern Europe and Sub-Saharan Africa. Of key countries in these regions:

- Nigeria rescheduled $1.6 billion in short-term, trade-related credits that were in arrears. The July agreement with banks eased banker concerns over the country's large arrearages.
- Yugoslavia and commercial banks signed a refinancing package in September, which included a rescheduling of $1.9 billion in short- and medium-term debt.
- Poland rescheduled about $2.1 billion in debt owed to banks in August. Discussions with Western governments regarding a Paris Club rescheduling of about $7.0 billion in official credits due in 1982-83 probably will begin this month. 25X1

Debt renegotiations are under way for several of the larger debtors that have not yet rescheduled this year. Venezuela's rescheduling talks on about $18 billion of external debt, however, are at an impasse because of the country's refusal to adopt an IMF austerity program, a necessary condition in bankers' eyes. The Philippines' financial situation has worsened severely in the past few months; 25X1 Manila has declared a moratorium on principal repayments and has set up a bank advisory committee to work out a solution to servicing its $3.5 billion in debt repayments due this year. 25X1

In our judgment, the outlook for the next year or so is one of continued debt repayment difficulties and additional reschedulings. The debt servicing problems of some countries—Mexico, Nigeria, and Romania, for example—probably will abate as a result of the current reschedulings, tough import cutbacks, and some improvement in export earnings. Others such as Brazil, Yugoslavia, and Poland will be forced to seek further rounds of reschedulings because of the magnitude and complexity of

25X1

their financial situations. We believe banks, governments, and the IMF will have to continue to work together to assist developing countries in coping with the debt problem by encouraging debtors to restrain their external financing needs, convincing lenders to sensibly reschedule existing debt and provide prudential amounts of new lending, and preparing governments and financial institutions for inevitable requests for bridge loans. [redacted] 25X1

[redacted] 25X1

Mexico: The Austerity Record and Economic Adjustment [redacted] 25X1

During his first year in office, President de la Madrid has done an impressive job in convincing Mexicans that tough economic policies have been necessary, and that they are being administered equitably. De la Madrid's actions have pleased the international financial community but seriously undermined economic performance and sharply reduced living standards. The cost of adjustment includes a 7 percent drop in economic activity this year. Because much still remains to be done to bring the massive foreign debt and rapid inflation under control, we foresee a continued deterioration of the economy. Moreover, broader structural reforms must be undertaken if Mexico is to avoid recurrent financial problems. [redacted]

We are concerned about the underlying potential for violence in Mexico that would test the ability and resolve of Mexico City. Next year will not be easy. Many Mexicans believe their situation will soon improve, and the clash between expectations and reality may present de la Madrid with a dilemma that jeopardizes sound economic policies and risks serious political problems. [redacted]

Harsh Austerity Steps

De la Madrid embarked on the tough stabilization program in large part because he believed he lacked responsible alternatives. Foreign lenders had abandoned Mexico. To restore economic order, he was faced with realigning consumption and investment patterns to reflect available resources. Among the steps he initiated were slashing wages and government spending, reducing consumer subsidies, relaxing price controls, and sharply devaluing the peso. (C)

Recent official data indicate that the austerity program has bitten deeply. The government deficit, imports, and consumption have all dropped further than economic planners or international observers had envisioned. It has taken these major adjustments, however, for Mexico to meet—and only by a slim margin—harsh IMF financial targets. [redacted] 25X1

Reducing Wages and Consumption. We believe the outstanding economic policy accomplishment of de la Madrid's first year in office has been in labor and wage policy. Last December's minimum wage negotiations—a traditional guideline for union settlements throughout industry—culminated in a moderate, two-stage wage boost for workers: 25 percent in January and 15.6 percent in June. As a consequence, real wages fell nearly 20 percent 25X1 during the first three quarters of 1983, and, barring unplanned hikes, will fall some 25 percent for the year. Government-affiliated unions are disappointed over the continuing fall in real wages, but their near unanimous compliance has helped cut the budget deficit, reduced pressures on prices, and protected jobs by easing business losses and minimizing bankruptcies. [redacted] 25X1 25X1

These steps, along with lower subsidies and widespread business losses, have substantially lowered personal consumption. Organized labor, including government workers, has been shielded by substantial fringe benefit packages. Workers earning minimum wages or less—at least 60 percent of the work force—and many independent merchants and other businessmen have not been so lucky. The government has continued subsidies on basic foods and public transportation to lessen the blow. Even so, Mexicans have eliminated luxuries, drawn down personal savings, and increased illegal work trips to the United States. [redacted] 25X1

Slashing the Public Deficit. Steep spending cuts and increased peso revenues from foreign and

Mexico: Foreign Financing Gap

Million US $

	1980	1981	1982 [a]	1983 [b]
Trade balance	−1,992	−3,003	7,802	13,000
Exports (f.o.b.)	16,840	20,927	22,224	22,000
Oil and gas	10,441	14,573	16,477	16,000
Manufactures	3,423	3,665	3,627	3,700
Agriculture	1,528	1,481	1,233	1,300
Minerals	1,448	1,208	887	1,000
Imports (f.o.b.)	18,832	23,930	14,422	9,000
Net services and transfers	−5,231	−9,541	−10,487	−9,400
Interest	−5,477	−8,383	−10,879	−11,400
Current account balance	−7,223	−12,544	−2,685	3,600
Debt amortization due	5,369	6,629	8,497	8,000
Financial gap	**−12,592**	**−19,173**	**−11,182**	**−4,400**
New medium- and long-term capital inflows	12,204	18,325	12,695	6,400
Rescheduled medium- and long-term external debt	0	0	4,000 [c]	19,000 [c]
Net short-term capital	5,187	10,233	−2,118	−17,000 [d]
Errors and omissions	−3,648	−8,373	−6,580	−1,000
Changes in reserves	1,151	1,012	−3,185	3,000
Other financial items				
External debt (at yearend)	50,700	74,900	80,800	84,100
Short term	11,100	22,500	23,200	10,000
Debt service ratio (*percent*)				
Due	43.5	48.7	63.1	63.8
After debt relief	43.5	48.7	50.1	47.4

[a] Estimated.
[b] Projected.
[c] Includes debt relief on $4 billion in 1982 and $5 billion in 1983 on medium- and long-term debt principal due; and $14 billion in 1983 in short-term debt rescheduled as long-term obligations.
[d] Includes rescheduled short-term debt.

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domestic oil sales reduced the public-sector deficit in January-June. Most of the progress came from cutting real spending substantially from 1982 levels. The most important factor in the cutback was the slashing of public-sector investment, particularly for oil development.

Mexico City made less progress on subsidies. Even though consumer subsidies were lowered sharply during the first half of 1983, the cuts fell short of the IMF goal of trimming them 40 percent. We believe subsidies for food, health, and education were reduced, while those for public transportation and electricity grew substantially.

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On the revenue side, higher peso income from foreign oil sales boosted real public receipts somewhat during the period. Earnings from other public-sector enterprises dropped sharply and the domestic tax base declined, causing nonoil federal government revenues to fall.

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Regaining Control of Foreign Accounts. The most visible aspect of austerity has been the turnaround in Mexico's foreign trade accounts. Sharply reversing the pattern since 1955, Mexico has run trade and current account surpluses averaging $1 billion and $300 million respectively each month so far this year. We estimate that such positive trade balances will continue, resulting in an unprecedented $3.6 billion current account surplus for 1983. An undervalued peso, lower government spending, and interrupted trade credit lines initially were most important in making these adjustments. More recently, depressed consumer demand has prevented an import rebound.

This dramatic turnaround on foreign payments substantially lowered new foreign borrowing requirements. Thus, Mexico City has been able to increase foreign exchange reserves and to repay arrearages on interest and suppliers credits as well as the $2.5 billion in emergency loans granted in August 1982 from the Bank for International Settlements and the United States. Foreign creditors were encouraged and rescheduled the bulk of principal payments coming due through 1984. Although capital flight has eased, we detect little capital repatriation.

Merchandise imports in January-September were slashed to $5.8 billion, less than half of the corresponding 1982 level, and just one-third of the 1981 amount. Private-sector imports plunged to one-third of the 1982 level and one-fifth of the 1981 level. Capital goods imports led the decline, dropping 80 percent between 1981 and 1983; private-sector capital goods imports plunged nearly 90 percent. At the same time, imports of consumer goods fell 75 percent and raw materials imports fell 60 percent

Depressed production and weak world demand for Mexican products—particularly oil—and underreporting of foreign exchange earnings have more than offset exchange incentives and caused the dollar value of exports to stagnate. Manufacturing and agricultural exports have shown only a 3-percent increase, and oil exports by value are down slightly because of lower prices. Only the mineral sector—traditionally geared toward exports—has expanded moderately. 25X1

Net service payments have declined, primarily because nonfinancial services have plunged. For example, the number of foreign tourists visiting Mexico has risen sharply, but the devaluations have cut foreign exchange receipts. The falloff in Mexican expenditures in the United States, however, more than compensated and allowed a substantial increase in net tourist revenues. 25X1

Meeting IMF Targets. Tough austerity kept Mexico in compliance with its IMF stabilization program in January-June. 25X1 Even so, official statistics indicate that Mexico City barely met the criteria for the public deficit and domestic credit. On the other hand, it exceeded its external performance targets—limits on foreign borrowing and increases in international currency reserves—by comfortable margins. While an IMF team is in Mexico now evaluating the third-quarter record, we—as well as Embassy officers—anticipate that Mexico City will pass this review. While we believe Mexico City has every intention of sticking to austerity, fourth- 25X1
quarter compliance is not assured. 25X1

Despite slashing government spending, the budget deficit was only 5 percent below its midyear IMF quantitative target. Even after cutting nonfinancial spending 30 percent, total public expenditures—combining the federal government and public-sector enterprises—exceeded the IMF target by 3 percent. Federal authorities performed best, while public-sector enterprises overspent. Higher peso earnings from oil exports boosted revenues above the IMF target, allowing Mexico City to come in just under target on the budget deficit. Staying 25X1
within the budget will be more difficult in October-December. Slippage is most possible in the budget accounts because additional steep cuts in public spending and probably a small net reduction in the public work force will be required 25X1

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Mexico: IMF Quarterly Performance Targets

	1982		Targets and Limits for 1983			
	September	December	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	Billion Mexican pesos					
Net credits to the public sector by the Bank of Mexico [a]	1,763	2,310	2,525	2,689	2,791	3,097
Cumulative overall public-sector deficit [b]		1,605	360	690	1,005	1,500
Cumulative change in net domestic assets of the Bank of Mexico	319 [a c]	635 [a c]	21	44	44	104
	Million US $					
Cumulative net foreign borrowing by the public sector [b]			1,250	2,500	3,750	5,000
Cumulative change in net international reserves of the Bank of Mexico [b]	734 [a]	−585 [a]		500	1,000	2,000
Cumulative reductions in arrears [b]						600

[a] End of period.
[b] Limit tested at the end of each period.
[c] Amount subject to ceiling is defined as the difference between note issue and net foreign assets.

[redacted] 25X1

While we expect the government to continue meeting lending targets to the public and private sectors, this will squeeze private borrowers. Rather than borrow from foreign bankers or the Bank of Mexico, the administration has used an unprecedented expansion of government bonds and more than doubled its borrowing from the nationalized banks. These actions have sopped up loanable funds. [redacted]

Sharply lower foreign borrowing has assured Mexico City of continued compliance with external targets. International reserves will grow by $3 billion or more this year, substantially above the $2 billion target. Moreover, Mexico City plans to reduce private-sector interest arrears by $800 million by yearend, well above the $600 million goal. [redacted]

Economic Tailspin in 1983

Steep Decline in Production. Economic activity is off markedly. Based on investment and consumption trends, midyear industrial statistics, and econometric studies, we estimate that domestic output fell at an annual rate of about 6 percent during January-June. Furthermore, we believe that the internal slump is intensifying and that the economy is now falling at an annual rate of 8 percent; household savings largely have been spent, real wages are falling steadily, and the government continues to restrain spending. Gross investment during the first half of this year was 30 percent below the 1982 level and 40 percent below the peak in 1981 [redacted]

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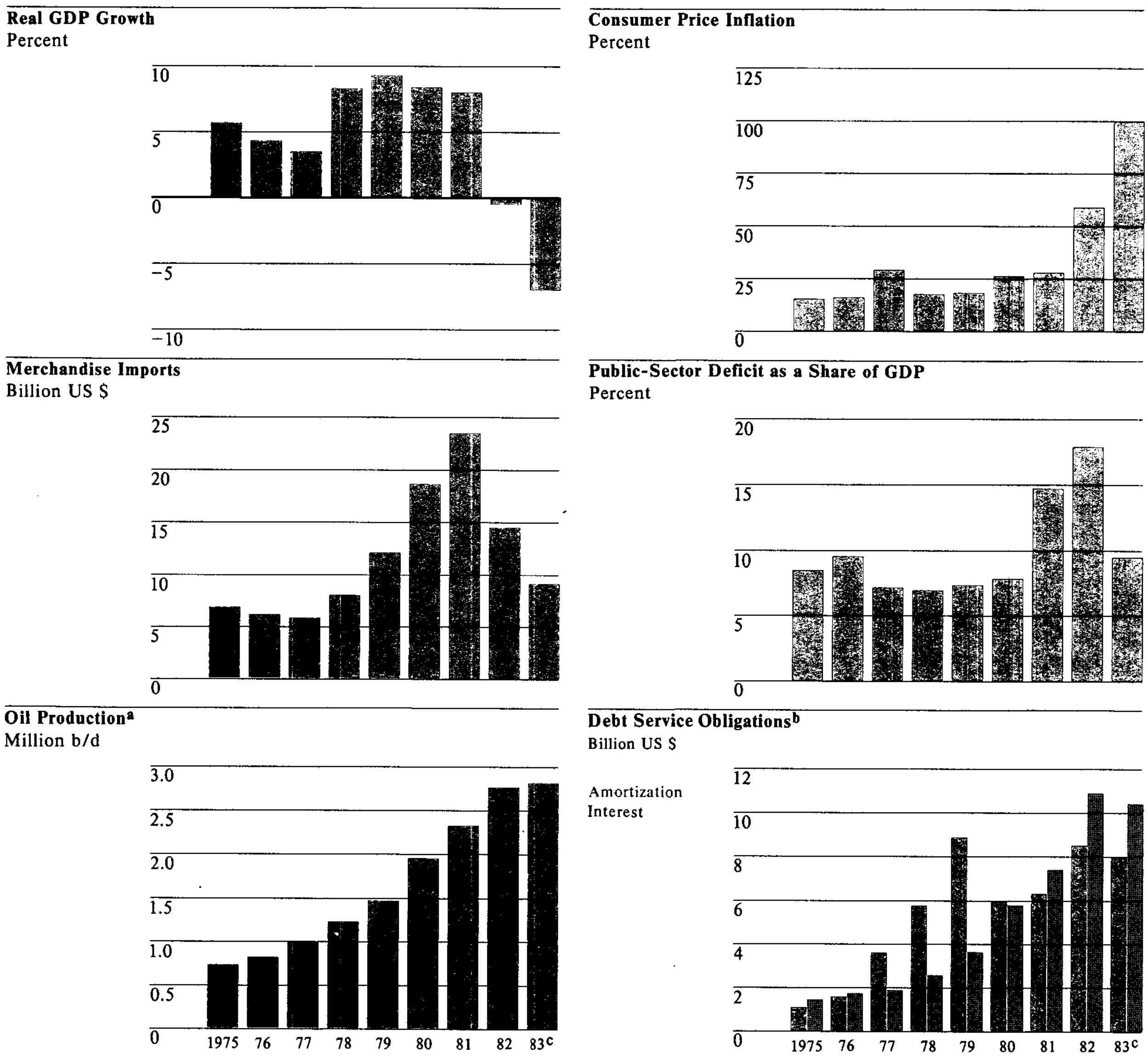
Mexico: Economic Indicators



[a] Excluding natural gas liquids.

[b] Interest on all debt, amortization due on medium- and long-term only; in 1982 debt moratorium and private sector arrears lowered actual debt payments $5 billion. In 1983 we expect debt rescheduling to reduce actual payments on interest and medium- and long-term debt by about $7 billion.

[c] Projected.

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Summary of Forecasts of Key Economic Variables, 1983

	Changes in GDP (*percent*)	Annual Average Inflation (*percent*)	Current Account Balance (*billion US $*)	Imports (*billion US $*)	Exports (*billion US $*)
Data Resources, Inc. [a]	−4.2	98.7	−1.3	10.6	20.5
Wharton Econometric Forecasting [b]	−5.1	101	−0.8	11.8	20.6
International Monetary Fund [c]	NEGL	81	−2.0	14.5	22.6
Central Intelligence Agency	−7.0	100	3.6	9.0	22.0
International Economic Analysis, Inc. in association with Evans Economics, Inc. [d]	−7.0	80	−0.7	11.1	18.8

[a] Latin America Review, Third Quarter 1983, Data Resources, Inc., September 1983.
[b] Latin America Outlook, Summer 1983, Wharton Econometric Forecasting Associates, July 1983.
[c] IMF Staff Report, 9 May 1983.
[d] Latin American Economic Outlook, Mexico Economic and Political Conditions and Prospects, September 1983.

[redacted] 25X1

We estimate that plant capacity utilization is down by a third or more in numerous industries as many factories reduced work shifts from three to two or less, and others have shut down completely. Official Mexican statistics show that industrial production declined at an annual rate of 10 percent in January-June and, according to preliminary statistics, 13 percent in the third quarter. Through September, production of motor vehicles and textiles dropped 50 percent, and new public- and private-sector construction plummeted 75 percent. Even the important minerals sector has not avoided the slump; in January-June mineral output fell 1 percent below a year earlier. [redacted]

The commercial sector is suffering because of dwindling supplies, lower purchasing power, and higher taxes. Sales data show that commercial activities have fallen 15 percent. While sales of basic consumer goods have changed very little, merchants report retail sales of other goods off 20 to 50 percent during the first half of the year. Preliminary reports indicate the sales slump worsened in the third quarter [redacted]

Agriculture may improve slightly this year with recent favorable rains in some areas that appear to have ended two years of widespread drought. Even so, recovery is limited by lower real farm price guarantees, shortages of fertilizers, machinery, seeds, and other imported inputs, and poor weather early in 1983; harvests will be far below predrought levels. Because of exchange incentives, we expect commercial export crops to increase slightly. Production for the domestic market from large irrigated farms is down, even though output in some rainfed areas is doing better [redacted] 25X1

Large Job Losses. Job losses—particularly among unskilled labor—have become severe. We believe the rate of unemployment has more than doubled since mid-1982 and now stands at over 20 percent. In the urban, nonunion private sector, unemployment stands at close to 30 percent; rural workers have tended to keep their jobs, because more are self-employed and the relationship between landlords and peasants is generally more paternalistic. Unionized, private-sector workers have fared better 25X1

25X1

because of flexible wage demands and reduced hours; we estimate that only 10 percent are out of work.

Government workers have done the best. We believe that increases in defense and internal security largely offset job losses in the rest of the federal government.

The bulk of the 800,000 young Mexicans that normally enter the labor force for the first time are having to resort to make-work jobs, staying in school, or looking across the US border for temporary work. Most new entrants have been added to the ranks of the underemployed.

Curbing Runaway Prices. Tough austerity measures and the effects of depressed demand are finally curbing inflation. After rising at a triple-digit rate in January-July, consumer prices in August and September slowed to an annual rate of 51 percent. During the last quarter of the year, we believe inflation will rebound a bit—to an annual rate of about 65 percent—because of scheduled public-sector price adjustments and the recent increases in peso devaluations. Average annual inflation for 1983 will total 100 percent, and much remains to be done if inflation is to be reduced substantially.

Looking Ahead

We foresee a slow economic recovery process because of the magnitude of Mexico's structural economic problems and the sizable financial requirements of its foreign debt. It will take at least two or three years before Mexico's production levels reach those of the early 1980s; it will take even longer for real personal consumption levels to rebound.

The number of years it takes Mexico to regain normal access to foreign capital markets and reestablish economic growth—and job creation—on a sustainable basis will depend in large part on whether de la Madrid continues basic economic reforms. In recent speeches—including his only formal press conference in early October—de la Madrid has emphasized that "tough and bitter steps remain to be taken." 25X1 Because we believe de la Madrid's priority remains to stabilize the economy and overcome inflation, the longer term outlook is favorable. Nevertheless, as political pressures mount, the chance of policy backsliding remains 25X1 significant. 25X1

A great deal also will depend on factors outside of Mexico City's control. Either a setback in the current world economic recovery or a deterioration in international finances—perhaps brought on by a debt default in another country—could preclude 25X1 any option of relaxing austerity. Alternatively, a major disruption in world oil supplies and the resulting higher prices could boost Mexico's oil revenue sufficiently to allow a moderate policy relaxation without seriously aggravating inflation or foreign payments problems. 25X1

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Italy: Dealing With Decline 25X1

The Socialist-led five-party coalition under Prime Minister Craxi has made inflation its top economic priority. Rome hopes to reduce inflation to 10 percent next year by trimming $30 billion from the projected budget deficit and holding down wage costs. The government's draft 1984 budget, however, has encountered criticism from all sides and has already been dealt some setbacks. We believe Rome will fall somewhat short of its budget targets this year and next, leaving the 1984 budget deficit at about 16 percent of GDP. Under these circumstances, the Italian economy will experience a weak recovery in 1984, following two years of GDP declines. Inflation should slow by about 2 percentage points, to 13 percent, while the current account deficit will narrow to less than $2 billion.

A Bleak Situation

Craxi inherited an economy in the throes of recession since 1980. Last year the situation worsened as slumping foreign and domestic demand caused a 0.3-percent drop in real GDP—only the second decline in the postwar period. The downturn was led by a 5.3-percent drop in investment, due in large part to high interest rates. Higher indirect taxes and delays in renewing collective bargaining agreements held down personal consumption. Recession in key foreign markets depressed exports. As a result, firms—particularly large concerns—laid off employees more rapidly than in the past, pushing unemployment to 9.1 percent.

There have been few signs of a rebound this year. After increasing slightly in the first quarter, real GDP plunged at a 7-percent annual rate during the April-June period. In July the unemployment rate rose to 9.7 percent. Investment, particularly in plant and equipment, has continued to sag under the effects of high interest rates and low profits. Higher taxes—part of the previous Fanfani government's austerity program—have reduced real disposable income and dampened consumer spending. Sluggish demand in foreign markets has constrained exports. 25X1

Business and consumer surveys show no significant improvement in the short term. Foreign and domestic orders have begun to pick up but remain well below normal. While surveys of future production trends point to some improvement, inventories remain relatively high. Industrial and consumer confidence indicators have become somewhat less pessimistic, but consumers are still hesitant about 25X1
purchasing durable goods. 25X1

In part because of the recession, Italy has experienced some reduction in inflation and the current account deficit. As monetary policy tightened to offset the inflationary impact of a burgeoning budget deficit and to strengthen the lira, inflation slowed by 2 percentage points in 1982 to 16.3 percent. At the same time, the trade deficit narrowed, as Italy benefited from soft oil and raw material prices. The improved trade account in turn cut the 1982 current account deficit to $5.5 billion, down from $8.1 billion in 1981. The trend of modest improvement in inflation and the balance of payments has continued in 1983 25X1

The Socialist Program 25X1

Craxi's economic program reflects the concessions made to the austerity-minded Christian Democrats and Republicans during the negotiations to form a new government. Under the compromise agreement, Rome is committed to placing the highest

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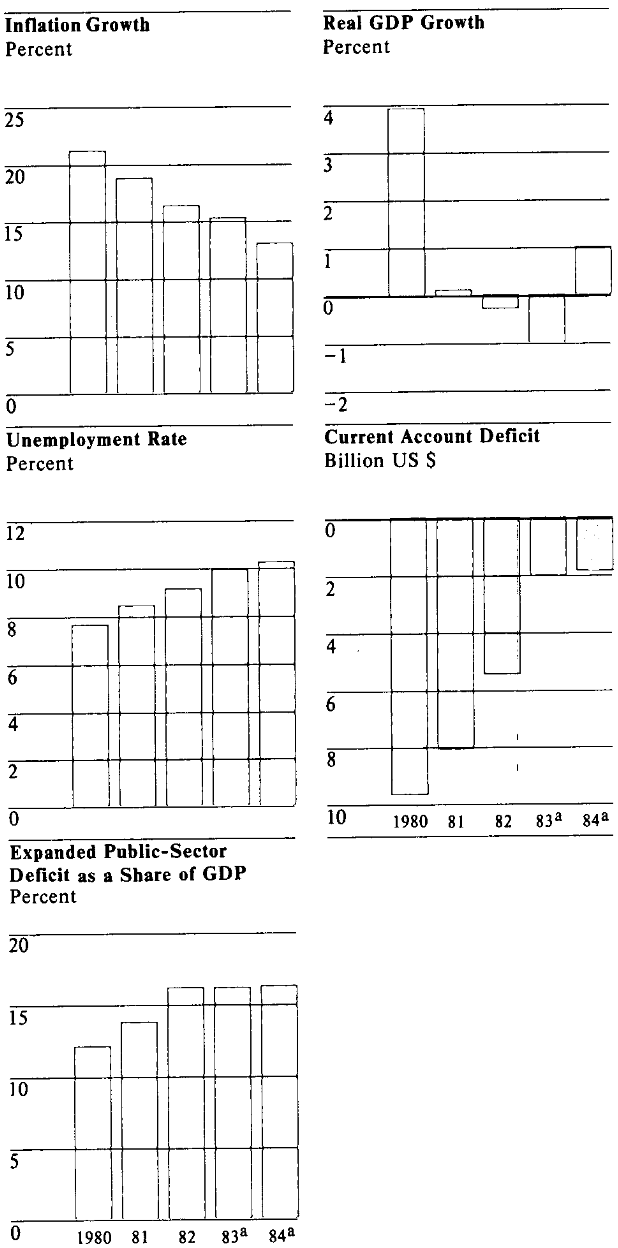
Italy: Economic Indicators



[a] Estimated.

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priority on fighting inflation in the short run and to promoting economic growth in the medium term. The government proposes to carry out its program by reducing the size of the budget deficit, holding down wage costs, and improving competitiveness. While still somewhat vague, the targets include:

- Holding the expanded public-sector deficit to $50 billion this year and $58 billion in 1984.
- Keeping real wages constant and holding price increases to 13 percent this year and 10 percent next year.
- Encouraging economic development over the next three years and stimulating exports.
- Increasing employment opportunities through a reform of the program for Italy's depressed southern region, the Mezzogiorno.

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As an initial step, the cabinet approved budget legislation designed to save $1.2 billion through cutbacks in health care and disability pension benefits. In addition, the government obtained a commitment from Italy's major retailing groups to keep price increases on 80 basic commodities in line with the 1983 inflation target. The government also settled the key metalworkers contract, avoiding potentially serious labor unrest early in the administration.

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Rome's efforts now are focused on the 1984 budget. According to official projections, without further action the deficit would soar to $88 billion—$30 billion above the target. To meet the deficit target, the cabinet approved an "austerity" budget which, according to Embassy reporting, included:

- Tax increases of $8.1 billion, including higher witholding on bank interest income, an 8-percent surcharge on local taxes, higher corporate taxes, and a renewal of 1983 tax increases.

- Social Security cuts of $3 billion, including reduced cost-of-living adjustments and a limitation in family allowances.

- Health service cuts of $3.1 billion.

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- Revenues of $5.2 billion from a tax amnesty program designed to collect penalties on building code abuses.

- Estimated "savings" of $7.5 billion, half from a lowered forecast of interest payments on the public debt and half from a redeposit of excess funds held in banks by regional authorities to the treasury's account.

Although strict by Italian standards, the proposed budget is aimed only at slowing the growth in spending rather than actual cuts. The program relies on increased tax receipts, financial transfers, and revised budget estimates for about 70 percent of the expected deficit reduction. For many of these measures—particularly lower debt service costs and receipts from the tax amnesty program—government estimates likely are overly optimistic. In addition, the budget does relatively little to tackle the long-run problem of excessive government spending, particularly social benefits

Prospects for Enactment

Despite agreement in principle among coalition members that austerity measures must be implemented, the Craxi program is in trouble. Labor unions, special interest groups, coalition members, and opposition parties have all criticized the budget. Some of the loudest complaints have come from the Christian Democrats (DC) whom Craxi has allowed to take the lead in formulating economic policy. Because of its election losses this year, the party is particularly sensitive to the impact of pension and health care cuts. Within Craxi's own party, the more ideologically inclined members are probably unhappy with the program.

The government already has encountered two setbacks. In its first legislative test, 27 Christian Democrats defected and the Chamber of Deputies rejected the tax amnesty law. According to press reports, the government will resubmit a slightly modified version of the plan. The other setback came when the courts ruled against some of the provisions designed to recoup funds from regional authorities. 25X1

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Key Role of Unions 25X1

We believe that controlling inflation in Italy will require a strong incomes policy. Unit labor costs rose about 17 percent last year, the highest rate among the Big Seven, and will increase about 15 percent in 1983. Labor productivity is stagnating, while nominal wages probably will rise by 25X1 about 15 percent this year, mainly because of cost-of-living increases. A moderation of adjustments in nominal wages plus increased productivity should help slow the increase in unit labor costs to about 12 percent next year. 25X1

An effective incomes policy almost certainly would include a reduction of Italy's wage indexation system. Confindustria, the employers federation, has urged the government to start talks soon. With sensitive budget issues under discussion, the government is in no hurry to broach the subject. In any case, the system, which was modified last January, is to be reviewed at the end of the year. According to press reports, the largest union—the Communist-dominated CGIL—may press for compensation because inflation will exceed the government's 13-percent target for 1983. 25X1

If the government is to have any chance of modifying wage indexation, it will have to handle organized labor skillfully. While the unions have not yet called for strikes, their umbrella group—the

United Federation—has criticized the Craxi program and plans an extensive lobbying effort. The CGIL has taken issue with the priority placed on fighting inflation and has already voiced its opposition to any major alteration of indexation. The Socialist-dominated UIL and Catholic CISL, on the other hand, have suggested they would consider a limited revision. According to the press, Craxi's ministers are considering instituting ceilings on indexation and adjustments to dampen the effects of exchange rate fluctuations. Union concessions would probably require government concessions in such areas as job creation and price controls.

Outlook

The slowness with which the government has moved on reining in this year's deficit, plus likely parliamentary delays, will keep Rome from hitting its policy targets. Press reports indicate that the government already has abandoned its 1983 budget goal. We estimate that the 1983 deficit will hit about $55 billion—10 percent above target and equivalent to 16.1 percent of GDP. We also expect the Craxi government to fall short of its policy goals for 1984. Faced with a huge public-sector deficit and wanting to protect the lira from further depreciation, the Bank of Italy is likely to keep monetary policy restrictive through 1984

We expect real GDP to be down about 1 percent this year. Because of high interest rates, low capacity utilization, and weak profits, investment spending will be off a further 3 percent. Consumer spending is being restrained by the uncertain economic outlook, the delay in the conclusion of new wage contracts, and adjustments in tax rates; for the year, it should drop by about 0.5 percent.

With the recession continuing, the current account balance and the inflation rate will show some improvement in 1983. Because of the decline in domestic demand, imports should contract more than exports, cutting the trade deficit to $4.5 billion. The improvement in inflation, however, will be less marked. Despite a slowing in recent months, inflation for the full year should come down only 1 percentage point to about 15 percent. 25X1

Given our assumption that Craxi will have partial success in meeting his policy targets, we believe Italy should experience a mild recovery in 1984. We expect GDP to rise about 1 percent compared to an OECD average of 3.6 percent. Exports will experience a small rebound but will be limited by the weak growth prospects in key markets—France, West Germany, and OPEC. With cost pressures easing and profits improving, business 25X1
investment probably will pick up despite high interest rates. Consumption will manage only a small increase as higher indirect taxes offset part of the real income gains. 25X1

We expect inflation to decelerate as wholesale prices stabilize, unit labor costs moderate, and increases in indirect taxes and public tariffs work their way through the system. A firming of import prices and continued depreciation of the lira, however, will contribute to holding inflation to about 13 percent, well above the projected OECD average of 6 percent and above Craxi's 10-percent target. The current account deficit should decline somewhat to $1.9 billion. 25X1

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Syria: How Socialist Is It?

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Despite President Hafiz al-Assad's strongly socialist rhetoric, Syria maintains a "dual economy" in which the failings of the state sector are partially compensated for by a thriving private sector that is allowed to evade official regulation. The "austerity" of the state sector has little impact on the comfortable life of many middle- and upper-class Syrians. They maintain themselves by smuggling in consumer goods financed by overseas earnings. Meanwhile, for all its other economic failings, the public sector has significantly improved the life of the impoverished rural population—a key goal of the socialist Ba'th Party and Assad's largely rural Alawite sect. The economic and financial cushion provided by the private sector's illegal activities helps cushion Assad against foreign financial pressures.

The Tangled Web of Syria's Exchange Regime

Syria maintains three officially sanctioned exchange rates. Most government agencies are permitted to buy foreign currency from the Central Bank at the ***official rate,*** *fixed since the 1950s at 3.925 pounds to the dollar. Those private-sector businessmen who receive permission to import goods legally are charged the* ***parallel rate,*** *introduced in early 1981, which has remained at about 5.4 to the dollar. The* ***tourist rate,*** *which was created in mid-1982 to be more "responsive" to market forces and encourage a greater share of worker remittances to flow through official channels, has normally been fixed at about 5.6. The market-clearing* ***illegal rate*** *is generally 3 to 4 percent greater than the tourist rate.* 25X1

Official Austerity

The widespread nationalizations of the 1960s pushed a significant share of the economy's resources—millions in capital and possibly as much as one-third of the skilled labor force—overseas, beyond the reach of the socialist leaders of Syria's ruling Ba'th Party. The wholesale departures of the 1960s continued during the mid-1970s as thousands of workers departed for the Persian Gulf, lured by oil money. We estimate that the uncounted earnings of this "overseas economy" probably run at least $750 million a year, equal to about 5 percent of GDP.

These foreign exchange earnings could be a rich source of funds for Damascus's hard-pressed treasury and public industries—if the government could lay its hands on the cash. Remittances have evaded official channels because of a more lucrative black market. Damascus has been unwilling to devalue the Syrian pound to avoid a loss of prestige and because the import subsidy that the state industries receive via the cheap foreign exchange helps make their goods competitive. The regime also is reluctant to face the choice of either hiking prices on imported, price-controlled commodities or subsidizing them more directly.

This dual system allows Damascus—which nominally controls almost all foreign exchange transactions—to lurch along with official reserves at rock-bottom levels and to resort to import restrictions and currency conservation measures. The most recent round of "austerity," for example, allowed the import of only the most essential items such as food and medicine. Damascus has also frozen all major development projects for a lack of cash, according to the US Embassy. Those few private-sector importers remaining inside the law who can get official approval to buy foreign goods wait up to nine months before Damascus's nationalized banks can dole out the requisite foreign exchange.

These policies, however, have produced a thriving currency black market that probably changes at least $600 million a year. Moneychangers buy the dollars of street-wise tourists and recipients of worker remittances and recycle them to importers who want to use the services of commodity smugglers. One US Embassy source has estimated that between $750 million and $1 billion of goods are smuggled in annually—which, if the estimate is accurate, would boost civilian imports about 25 percent above official totals.

The smuggling of commodities financed by the currency black market has rendered most government restrictions on consumer imports meaningless except for those who insist on remaining inside the law. Western consumer goods are widely available, despite the government's strictures. According to the US Embassy, the practice of evading currency and import controls has become so broadly accepted and profitable that even government agencies get into the act; the Embassy reports that one military construction unit routinely buys some $100 million a year on the black market to finance imports. On the supply side, both civilians and military officers—particularly those stationed in Lebanon—are major traffickers in smuggled goods. US Embassy sources claim that military officers operate warehouses stocked with furniture, appliances, and home entertainment equipment—one need only place an order to have it delivered by military vehicle within a day or two. There are villages on the Lebanese border, according to the Embassy, where smuggling is the mainstay of the local economy and the main streets are bazaars of contraband goods.

Tacit Government Approval

In an authoritarian state such as Syria, the obvious thriving of *sub rosa* private markets must be regarded as tacit government policy. While the uneasy coexistence of the two competing systems does deprive the public sector of resources, it holds important political benefits for Assad. By clinging publicly to the mantle of Ba'th Party ideology—of which state domination of the economy is a key element—President Assad can help legitimize his one-man rule and avoid the increased inefficiency and consumer dissatisfaction that would result from greater state control. Second, the underground trade, one of the few spheres in which people can act independently of state control, helps forestall more open opposition to Assad's sometimes heavyhanded approach. At the same time, by making it very hard for anyone to do business legally, Assad keeps the business community psychologically and financially vulnerable and impresses on them the profitability of not antagonizing the regime. The system helps keep public factories operating and workers employed because the nationalized industries use the black market to obtain raw materials.

Assad is a member of the traditionally impoverished, rural Alawite sect. One of his key aims has been to break the lock on Syria's economic life traditionally held by Sunni Muslims and to improve the economic standing of his coreligionists. The existing structure serves that aim well. The basis of the Sunnis' previous predominance—privately held banks, factories, and large farms—has been undermined by land reform efforts and nationalizations. The emerging domestic economic elites are those who exploit their influential connections with the government and military to provide undisturbed smuggling and other illegal services. Alawites, who hold most key positions in the government and provide a disproportionate number of Army officers, profit most.

Finally, while the underground economy does drain off substantial customs revenues that would otherwise flow into government coffers, Assad has devised a rather unorthodox method of taxing the moneychangers. On occasion, when the official system's currency shortage becomes particularly acute, Assad launches short-lived currency crackdowns, arresting moneychangers and confiscating their cash. The culprits are typically released within a few days—but only about three-fourths of their cash is returned.

Over the long haul, however, this dual system of a lumbering public sector and a thriving private sector forced to live outside the law retards Syria's economic development. Instead of investing in industrial capacity at home, the private sector has turned its energy and resources to making money overseas and to smuggling. The public sector, meanwhile, is handicapped by a lack of cash—particularly hard currency—poor planning, and mismanagement. It must be protected by expensive subsidies in order to compete with imports.

Welfare Syrian Style

For all its other economic failings, Assad's government has made significant improvements in the material lot of Syria's lower classes—long an explicit government and Ba'th Party goal. The improvement is primarily a result of basic human needs–oriented projects whose benefits are not immediately captured in economic growth statistics:

- Government clinics provide free health care to rural residents and to those citydwellers falling below a minimum income.
- Hundreds of villages have been electrified and thousands of kilometers of roads paved since Assad's accession to power.
- The percentage of children attending school has risen sharply in rural areas—particularly in Assad's home district of Latakia, where most Alawites live.

Despite Syria's 3.5-percent population growth rate and rapid migration to the cities, urban unemployment is low by Third World standards. Wage laws and employment policies at state industries serve as surrogates for formal unemployment insurance and income maintenance programs. Local observers agree that state industries are vastly overstaffed and are employers of last resort. For example, the proprietor of a small, privately owned textile factory told a visiting US official that a state factory of similar output would employ four or five times the number of workers he employed.

Implications for the United States

The economic and financial cushion provided by the black markets makes Syria less susceptible to economic pressures from Arab or other states than the government's low foreign exchange reserves—last reported at $113 million—would imply. Even if foreign economic pressures forced the public sector into a truly dire cash squeeze, supplies of consumer goods and domestic opposition to Assad would remain relatively unaffected. If necessary, the private currency markets offer a source of foreign exchange that could again be tapped on short notice in a new crackdown.

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Free World Competition for Commercial Space Services [redacted]

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Over the coming decade, the United States will face growing competition in commercial space services. West European and Canadian firms, supported by a variety of government programs, are already making inroads into lucrative markets for launch services and communications satellites. West European and Japanese firms are also well positioned to capture sizable shares of future markets for remote sensing and materials processing. Taken together, industry observers estimate that the market for these activities could be worth up to $75 billion—at current prices—over the next 10 years. ([redacted]

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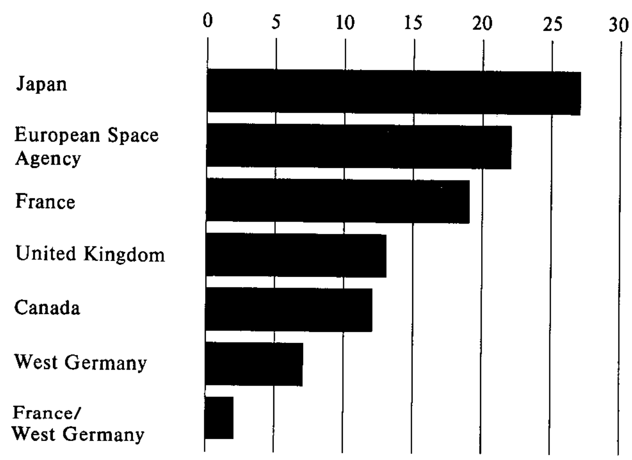
Launch Services

The European Space Agency (ESA) will provide the only commercial competition for the United States for space launch services during the remainder of the 1980s. ESA officials have stated that they hope to capture up to one-third of the commercial launch services market over the next decade. This market has been estimated at $6-15 billion by industry sources. [redacted]

ESA is pinning its hopes on its Ariane family of expendable launch vehicles. The current Ariane is capable of placing a 950-kg load into geosynchronous orbit; later versions have a design capability of 3,300 kg into geosynchronous orbit or 15,000 kg into low Earth orbit. Although some potential customers are skeptical of Ariane's performance—there have been two failures out of seven launches and one of two satellites was lost on the sixth launch—ESA officials believe they can capture market share by offering lower prices for launch services. ESA is bidding only 83 percent of the price asked by NASA to put Intelsat VI into orbit. ESA currently has contracts for 35 payloads through 1990. [redacted]

Free World Foreign Satellites Launched Through October 1983



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We do not foresee any Japanese competition in the launch services market for the remainder of this decade because agreements with the United States restrict the Japanese from commercializing their current space launch vehicle. Depending on the amount of US technology used, similar restrictions may apply to their next-generation space launch vehicle. By the mid-1990s, however, the Japanese plan to have a high-energy booster capable of placing over 12,000 kg into low Earth orbit or 2,000 kg into a geosynchronous orbit. This launch vehicle is being designed to be competitive with both the Ariane and the US Space Shuttle. [redacted]

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European Space Agency's ERS-1 Earth resources spacecraft

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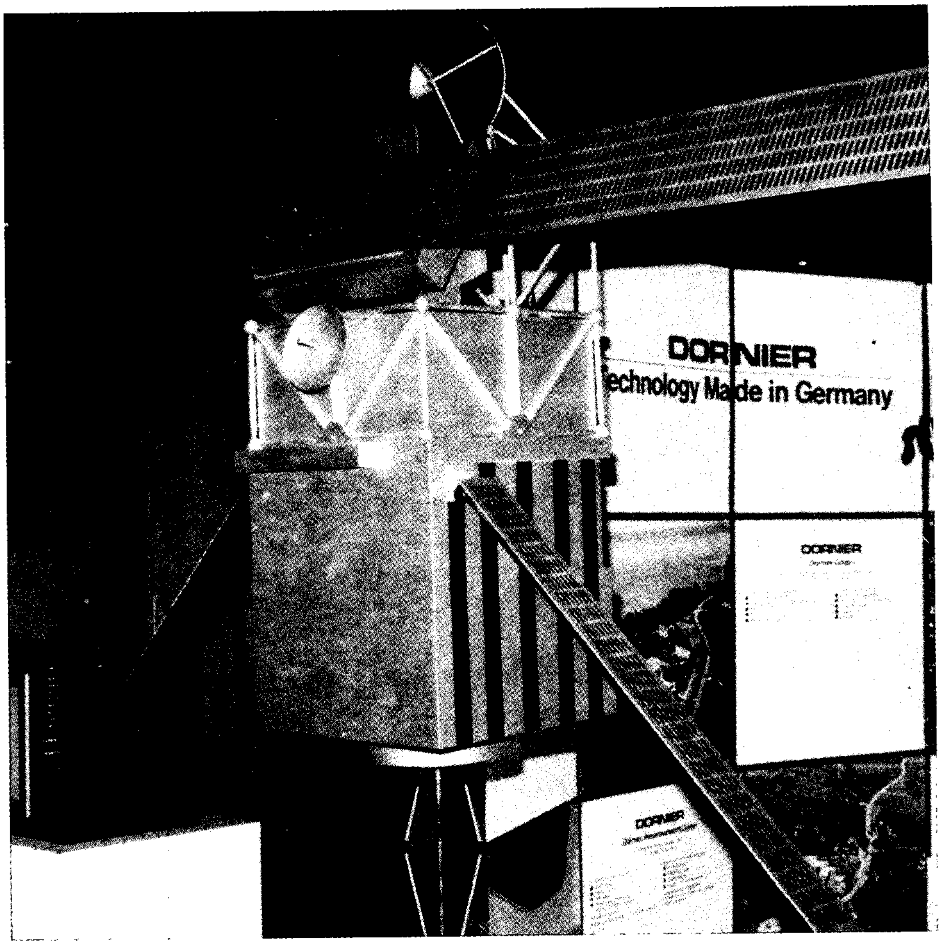

Communications Satellites

Satellite communications systems represent the largest segment of the commercial space services market. The market for these systems could approach $45 billion over the next decade, according to industry sources and trade publications. The market for satellites themselves (including direct broadcasting) is expected to reach $6-15 billion; the earth stations and ground equipment market is estimated at $5-10 billion; the market for home receivers for direct broadcasting—costing $300 to $500 each—could reach up to $20 billion.

Although the West Europeans have limited experience in manufacturing and operating communications satellite systems (the first operational European communications satellite, ECS-1, was launched in June 1983), ESA has initiated ambitious programs in this area. Through these programs, European aerospace consortiums are developing a wide range of modular communications satellite buses [1] that offer competitive performance with those built in the United States. Indeed, the French company Aerospatiale, with a US firm as a major subcontractor, has won the contract for the Arabsat communications satellite system.

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Canadian officials have targeted 10 percent of the international market for communications satellites and satellite ground stations within the next decade. We believe they will achieve this goal.

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[1] A satellite bus contains the power supply, telemetry, and attitude control system.

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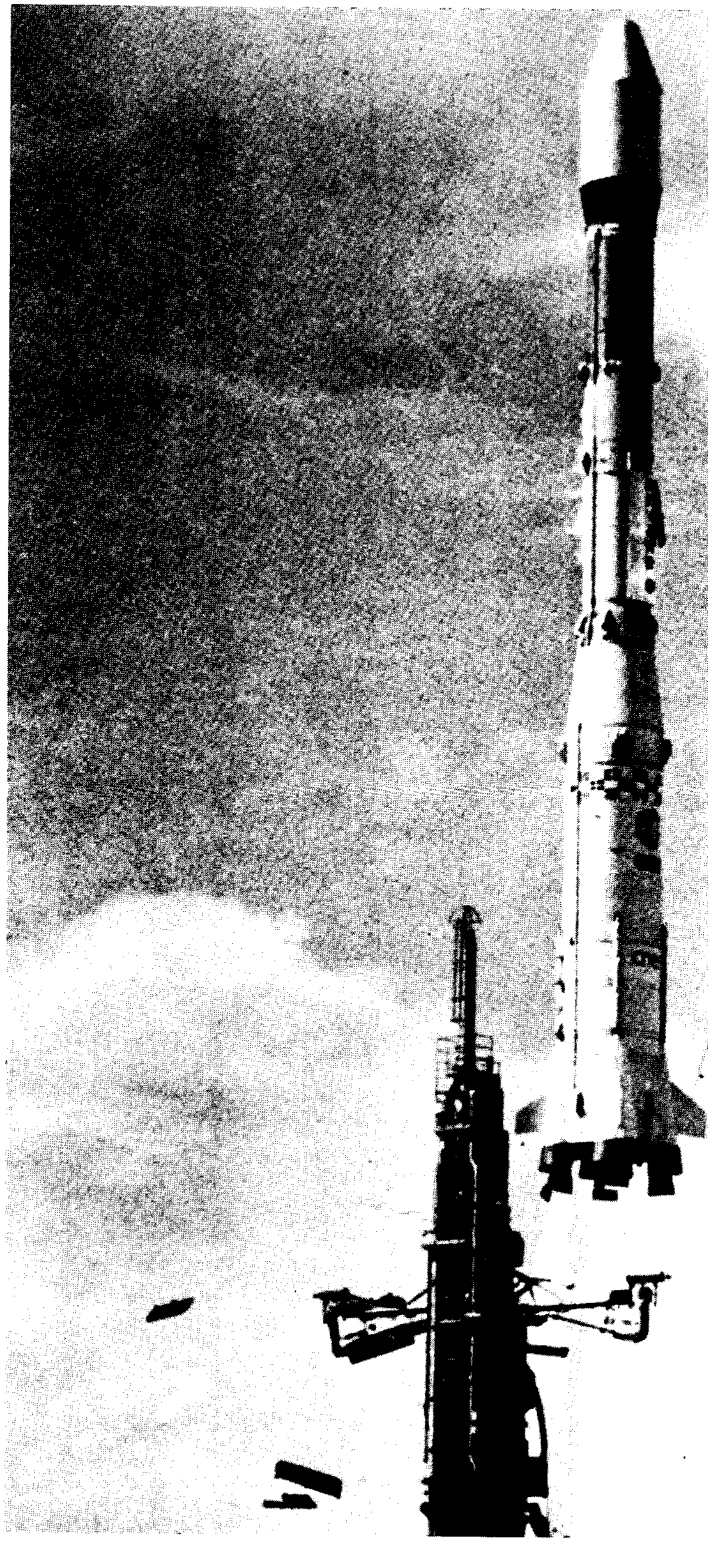

European Space Agency's Ariane launch vehicle

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Comparison of Country Space Programs

	Government Budget for Space Program, 1983 *(million US $)*	Launch Vehicles	Satellites Planned	Materials Processing Program
Canada	100	None	3 communications, 1 remote-sensing	No
European Space Agency (ESA)	700	Ariane family	4 communications, 1 remote-sensing, 3 weather, 4 scientific	Yes
France [a]	450	None (prime contractor for Ariane)	4 communications, 4 remote-sensing	No
West Germany [a]	350	None (second stage for Ariane)	2 communications, 3 scientific	Yes
United Kingdom [a]	100	None	1 communications, 1 military	No
Japan	460	Mu-3S (small) N-2 H-1 (under development) H-2 (proposed for 1990s)	7 communications, 5 remote-sensing, 4 scientific	Yes

[a] Some of these funds go to ESA.

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Canada is a pioneer in direct-broadcasting satellites and was the second nation (after the USSR) to establish an operational domestic communications satellite system. Moreover, the Canadians were the first to use geosynchronous orbit for these satellites (the first Canadian Anik-A communications satellite was launched in 1972; the first domestic US communications satellite, Westar A-1, was launched in 1974).

A key factor in the success of Canada's space program has been its pursuit of a close working relationship with NASA and the US aerospace industry. The Canadians have combined their aerospace capabilities into a single company, SPAR Aerospace of Canada, to design, develop, and manufacture satellites. SPAR began its relationship with the US aerospace industry as a subcontractor to a US firm for the early Anik communications satellites. SPAR now is the prime contractor for current generations of Anik, and a US firm is the main subcontractor. Brazil and Nigeria have contracts with SPAR for communications satellites and ground stations; again the major subcontractor is a US firm.

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European Multinational Consortiums: Space Program

	Companies	Country	Type of Satellite	Production (*number of satellites*)
Satcom International	British Aerospace	United Kingdom	OTS-1	1
	Matra	France	OTS-2	NA
	Selenia Spazio	Italy	Marecs	1
			ECS	5
			Telecom-1	3
			Skynet 4	2
			Unisat	3
			Apex	1
			SPOT	2
Eurosatellite	Aerospatiale	France	TDF	2
	MBB	West Germany	TV Sat	2
	Thomson	France	Tele-x	2
Olympus Group	British Aerospace	United Kingdom	Olympus; derivatives	NA
	Fokker	Netherlands		
	Aeritalia	Italy		
	Selenia Spazio	Italy		

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Remote-Sensing Satellites

After 1985, France should be in a good position to capture a significant share of the market for remote-sensing satellite imagery. France is currently promoting its remote-sensing satellite program, called SPOT. Simulated SPOT data from aircraft are being marketed to acquaint potential users with the characteristics of SPOT imagery. SPOT is scheduled to be launched in 1985 and is to be operated by a French-subsidized company, SPOT-IMAGE. This firm plans to offer imagery with a much higher resolution than US Landsat imagery but at comparable prices. There are currently no plans to launch additional Landsat satellites after the launch of Landsat D-Prime in 1984. Although the market for remote-sensing imagery has been small, averaging only $35 million a year, industry observers have estimated that it could grow to between $400-500 million annually over the next decade. 25X1

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The Japanese plan to launch a maritime observation satellite in 1986 and an earth-resources satellite in the early 1990s. The earth-resources satellite is designed to have about the same resolution as the US Landsat. Based on our knowledge of the current state of Japanese satellite programs, we believe they would have to rely on US firms for some key components, engineering expertise, and systems integration. It is likely, however, that the French, with their plannned high-resolution earth-resources satellite, could dominate the market by the time the Japanese satellite is orbited.

Although Canada does not plan to commercialize its radar-sensing satellite system, it has the only firm that is currently selling civilian space-based synthetic aperture radars. US firms are unable to market commercial versions of their radars because of military applications. These radars are used for geologic mapping and can generate images of regions hidden by clouds or in darkness. MacDonald Dettwiler, the Canadian firm, is furnishing the synthetic aperture radars for both the Canadian Radarsat and the ESA remote-sensing satellite, ERS-1

Materials Processing in Space

We do not believe that space-based materials processing will develop before the 1990s. No country, except perhaps the USSR, will have commercial Earth-orbiting materials processing centers until that time. Products that may eventually be processed in space include pharmaceuticals, microelectronics, large crystals, immiscible alloys, foamed steel, and monocrystalline filaments. Space processing of these items is attractive because of a low-vibration, low-gravity environment. NASA has estimated that the world market for space-produced materials may reach $20 billion annually in the 1990s. An industry assessment estimates that by 1995 at least $5 billion worth of pharmaceuticals manufactured in space will be sold each year.

The West European and Japanese space-based materials processing programs are very similar. Both programs currently use suborbital rockets to create short periods of microgravity for research purposes and will use the Spacelab laboratory module on the US Space Shuttle for long-duration microgravity experimentation. In 1986, a reusable European satellite, Eureca, is scheduled to be orbited by the US Space Shuttle. Eureca is the forerunner of an automated materials processing facility. In the 1990s, both ESA and Japan hope to have unmanned materials processing facilities serviced by their own spaceplanes. 25X1

West Germany is the prime contributor to the ESA Spacelab program. West Germany also is building its own version of the Spacelab, which will be used to develop techniques for a microgravic space industry. A West German consortium has built a retrievable satellite that will be used to test equipment for free-flying remote sensing and materials processing modules. The consortium wants to commercialize this satellite for customers seeking a vibration-free microgravic environment. 25X1

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Implications

Growing foreign competition in space services poses a number of challenges to the United States, both on the commercial and security fronts. On the commercial front, not only will US firms lose market share in another high-technology area, but they may also become dependent on foreign companies for vital services such as remote-sensing imagery for resource development. On the security front, the US Government will have more difficulty controlling the flow of technologies to the Soviet Bloc as vendors of commercial space services proliferate. Many of the technologies in this area are directly applicable to military systems, especially the remote-sensing optical and radar systems, and the wider availability of these technologies will facilitate Soviet and Bloc efforts to acquire advanced Western technology. 25X1

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